BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
ROY C. AND THELMA A. JONES)

Appearances:

For Appellants: Archibald M. Mull, Jr., Attorney at Law

For Respondent: Wilbur F. Lavelle, Associate Tax Counsel

O P I N I O N

This appeal is made pursuant to Section 18594 of the Revenue and Taxation Code from the action of the Franchise Tax Board on protests to proposed assessments of additional personal income tax in the amounts of $3,728.18 assessed against Roy C. and Thelma A. Jones jointly for the year 1951, $1,902.65 assessed against each of them for the year 1952 and $5,743.06 and $8,265.59 assessed against them jointly for the years 1953 and 1954, respectively.

Appellant' Roy C. Jones (hereinafter called Appellant) conducted a coin machine business in the Mojave Desert area under the name of Desert Amusement Company. Appellant owned about 25 to 30 bingo pinball machines, some music machines, some cigarette vending machines, some miscellaneous amusement machines and, for at least a portion of the period, some punchboards. The equipment was placed in various locations such as bars and restaurants. In addition, during the years under appeal Appellant and a partner owned and operated the Porthole Cafe in Ridgecrest. At the latter location Appellant placed two multiple-odd bingo pinball machines, a music machine, two cigarette vending machines, a shuffleboard and a weighing scale.

The proceeds from each machine except cigarette machines, after exclusion of expenses claimed by the location owner in connection with the operation of the machine, were divided, usually equally, between Appellant and the particular location owner. The proceeds from the punchboards were divided 60 - 40. with the location owner receiving the larger amount. No detailed information was introduced with respect to the operation of the cigarette machines and apparently the gross income therefrom is not in issue. On the books of Desert Amusement Company, the Porthole Cafe was treated the same as any other location.

The gross income reported in tax returns was the total of amounts retained by Appellant from locations. Deductions were

taken for depreciation, cost of phonograph records and other business expenses. Respondent determined that Appellant was renting space in the locations where his machines were placed and that all the coins deposited in the machines constituted **gross** income to him. Respondent also disallowed all expenses, except the cost of cigarettes, pursuant to Section 17359 (now 17297) of the Revenue and Taxation Code which read:

> In computing net income, no deductions shall be allowed to any taxpayer on any of his gross income derived from illegal activities as defined in Chapters 9, 10 or 10.5 of Title 9 of Part 1 of the Penal Code of California; nor shall any deductions be allowed to any taxpayer on any of his gross income derived from any other activities which tend to promote or to further, or are connected or associated with, such illegal activities.

The evidence indicates that the operating arrangements between Appellant and each location owner were the same as those considered by us in Appeal of C. B. Hall, Sr., Cal. St. Bd. of Equal., Dec. 29, 1958, 2 CCH Cal. Tax Cas. Par. 201-197, 3 P-H State & local Tax Serv. Cal. Par. 58145. Accordingly, we conclude that Appellant and each location owner were engaged in a joint venture in the operation of these machines and punchboards.

During the years under appeal, Appellant was entitled to one-half the amounts deposited in the two bingo pinball machines, the music machine and the weighing scale located at the Porthole Cafe as the machine owner and to one-fourth of such amounts as a co-partner in that location and therefore three-fourths of these amounts were includible in his gross income.

In Appeal of Advance Automatic Sales Co., Cal. St. Bd. of Equal., Oct. 9, 1962, CCH Cal. Tax Rep. Par. 201-984, 2 P-H State & Local Tax Serv. Cal. Par. 13288, we held the ownership or possession of a pinball machine to be illegal under Penal Code Sections 330b, 330.1 and 330.5 if the machine was predominantly a game of chance or if cash was paid to players for unplayed free games, and we also held bingo pinball machines to be predominantly games of chance.

At the hearing of this matter, five location owners, including Appellant's partner in the Porthole Cafe, testified that cash payouts were made on bingo pinball machines. We conclude that it was the general practice to pay cash for unplayed free games to players of Appellant's bingo pinball machines. Accordingly, this phase of Appellant's business was illegal, both on the ground of ownership and possession of bingo pinball machines which were predominantly games of chance and on the ground that cash was paid to winning players.

In addition, the evidence indicates that punchboards were placed at about five locations and that something of value was furnished to winning players, Accordingly, the punchboards were operated in violation of Sections 319 and 330a of the Penal Code. (Appeal of Raymond H. and Mayme Moses, et al., this day decided.)

In view of the illegal operation of bingo pinball machines and punchboards, Respondent was correct in applying Section 17359.

Appellant and his employee collected from and serviced all types of machines. Appellant's coin machine business was highly integrated and we find that there was a substantial connection between the illegal activity of operating bingo pinball machines and punchboards and the legal activity of operating music machines, vending machines and miscellaneous amusement machines. Respondent was therefore correct in disallowing the expenses of the entire business.

There were not complete records of amounts paid to winning players on the bingo pinball machines and Respondent estimated these unrecorded amounts as equal to 29 percent of the total amount deposited in such machines. Respondent's auditor testified that the 29 percent figure was based on several collection tickets which showed payouts. The 29 percent payout figure appears reasonable and in the absence of other information it must be sustained.

In connection with the computation of the unrecorded payouts, it was necessary for Respondent's auditor to estimate the percentage of Appellant's recorded gross income arising from bingo pinball machines since the records segregated cigarette income but the income from pinball machines, music machines, punchboards and miscellaneous amusement machines was lumped together. Respondent's auditor testified that he had used the estimates obtained from Appellant in segregating the bingo pinball income, Under the circumstances, we can see no reason to disturb this segregation.

In connection with the reconstruction of Appellant's gross income we note that there -were two locations where the proceeds of the machines were not divided equally, thus requiring separate computations. These locations were the Porthole Cafe, where Appellant was entitled to 75 percent of the proceeds and a V.F.W. post where Appellant was entitled to 40 percent of the proceeds. In each of these locations there were two bingo machines. In the absence of actual figures, the portions of the total proceeds from all bingo machines which are attributable to the bingo machines in these locations should be computed according to the numerical ratios which these machines bore to all of the bingo machines. Although Appellant had other equipment in these two locations, we have no reasonable basis for segregating the

proceeds attributable to that equipment. There is, in any event, an offsetting tendency due to the fact that Appellant received more than half of the proceeds from one of these locations and less than half from the other.

O R D E R

Pursuant to the views expressed in the opinion of the Board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to Section 18595 of the Revenue and Taxation Code, that the action of the Franchise Tax 'Board on protests to proposed assessments of additional personal income tax in the amounts of $3,728.18 assessed against Roy C. and Thelma A. Jones jointly for the year 1951, $1,902.65 assessed against each of them for the year 1952 and $5,743.06 and $8,265.59 assessed against them jointly for the years 1953 and 1954, respectively, be modified in that the gross income is to be recomputed in accordance with the opinion of the Board. In all other respects the action of the Franchise Tax Roard is sustained,

Done at Pasadena, California, this 21st day of October, 1963, by the State Board of Equalization.

John W. Lynch, Chairman

Geo. R. Reilly, Member

Paul R. Leake, Member

Richard Nevins, Member

_____, Member

ATTEST: H. F. Freeman, Executive Secretary